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STUDY ON SHAREHOLDER'S DEFECTIVE CAPITAL CONTRIBUTION AND CIVIL LIABILITY

TANG Ke^{[a],*}

[a]Changchun University of Science and Technology, Changchun, China.

*Corresponding author.

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Abstract

Although the existing corporation law of China makes the restriction and liability regulation on shareholder's defective capital contribution, it is mainly conducted for the limited liability company rather than the incorporated company. Hence, it discusses the shareholder's defective capital contribution in Chinese corporation law and the civil liability it should undertake. It is hoped to find out the effective way to solve the problem of shareholder's defective capital contribution in China.

Key words : Shareholders' defective; Contribution; Liability; Comparative study; The Corporate Law

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INTRODUCTION

The existing construction system of China only emphasizes that shareholders must promptly make the sufficient contribution of capital and transfer the ownership of contribution. After the foundation of the company, they cannot withdraw contributed capital. However, it doesn't establish the reasonable prevention mechanism to prevent and reduce the behavior of shareholder's defective capital contribution and never provides the reasonable regulation aiming to the defective capital contribution happening in the practice. Besides, the current defective capital contribution liability system only stipulates the liability of breaking contributed contract of the limited liability company, substantial responsibility of capital, crime of feigned investment as well as the criminal responsibility and administrative responsibility of withdrawal of capital. The legislation relevant to the civil liability

is severely lacking. The relevant regulations are so simple that they cannot provide the good legal prevention and remedy for the defective capital contribution. Thus, it is very necessary to make the deep research on the legal problems including the shareholder's defective capital contribution and civil liability.

1. OVERVIEW OF DEFECTIVE CAPITAL CONTRIBUTION

1.1 Concept of Defective Capital Contribution

In Chinese theoretical field, there are various definitions about the shareholder's defective capital contribution. Jiang (2001) thinks that, under the situation of the clear rules conducted by the law on the shareholder's capital contribution, if the shareholder's capital contribution is not consistent with these rules that the property or property right contributed by the shareholder has the defect or other contributed behaviors have the defect, the defective capital contribution is generated. Zhao (2005) demonstrates, "the defective capital contribution is that the property provided by the shareholders has the defect in the quality or right, including the natural defect and legal defect." Li & Wang (2005) indicates that the defective capital contribution is classified into the feigned capital contribution and the withdrawal of capital. The feigned capital contribution can be further classified into the no contribution, insufficient contribution and improper contribution.

Above all, the author holds the view that the shareholder's defective capital contribution is that the shareholder is not in accordance with the contribution requirements regulated by the law or the articles of company or there are behaviors which are not completely fit for the law or articles of the company in shareholder's contribution way and the disposition on the contribution. Shareholder's defective capital contribution is the specific generalization of shareholder's breach of the obligation of capital contribution. The shareholders, especially the sponsor, have the strict capital contribution obligation. They must fulfill the obligation of capital contribution. They cannot breach the duty in any way.

1.2 Manifestation of Shareholder's Defective Capital Contribution

The current Corporation Law of China indicates that there are various ways of shareholder's defective capital contribution. The main manifestations include improper capital contribution, false investment and withdrawal of contribution as well as transfer of the company asset.

Article 27 in Chinese Corporation Law regulates, "Shareholders can use the currency for the capital contribution. They can also use the non-monetary assets including the objects, intellectual property and land use right that can be evaluated by the currency and transferred by law for investment. Yet, the property that cannot be utilized as the contribution according to the stipulation of the law and administrative regulation is exceptional. For the non-monetary assets used as the investment, they should be evaluated. The property should be verified. They cannot be overvalued or underestimated. The law and administrative regulation have made the stipulations on the assessment. All should follow stipulations." The behavior of breach of the obligation of capital contribution can be classified into the following types. For the investment in cash, the delay in delivery and withdrawal of capital happen. While shareholders use material objects for investment, they

may refuse to provide the conveyance of property or there is the defect or loss of the subject matters. While the contribution is conducted with the industrial property, it is never evaluated by the professional institution and the property right has the defect. While the contribution is made with the non-patent technology, the non-patent technology may not be what the company needs. Also, the leak of technology may happen. Or, the actual value doesn't conform to the capital share that shareholders purchase. When the contribution is made with the land use right, the shareholder may not deal with the relevant procedures and the land use right may be forbidden to transfer.

To sum up, the breach of the obligation of capital actually includes the non-performance of the investment obligation and the defective performance of the investment obligation. The former one is that shareholders don't perform and refuse to perform the investment duty after subscribing shares. Or they perform the obligation of capital in form yet never making the investment actually. Or, due to the legal or objective factors, shareholders cannot perform the duty not to help the company get any property interest. The latter is that shareholders perform the obligation duty after subscribing shares. However, their performances are defective, incomplete or improper. The defective performance of the contribution obligation can be classified into the delay in performance, false investment, defective performance and withdrawal of capital. The common effect of the defective capital contribution is that the company capital cannot reach the amount determined by the article. Consequently, the company capital is false. In such case, it is not only bad for the company to implement the business activities but also may harm the interest of the relative persons who trade with the company and endanger the safety of social exchange.

1.3 Harms of Shareholder's Defective Capital Contribution

1.3.1 Harm to the Company

The company capital is the material basis of the company operation. The obligation of the capital contribution is the legal duty that shareholders should undertake for the company. The defective capital contribution is the non-fundamental breach of the capital contribution liability.

1.3.2 Harm to Other Shareholders

Under the principle of the equal shares enjoying equal rights, the shareholders of the defective capital contribution undertake fewer obligations but enjoy the equal rights as what other shareholders who have properly performed their duties have. Actually, it is a kind of deprivation of other shareholders' rights.

1.3.3 Harm to Company Creditors

The minimum protection for the trade between creditors and the company is the registered capital of the company. Due to the defective capital contribution of shareholders, the real capital of the company will change. It is hard to well manage the company capital, which undoubtedly weakens the general guarantee of the realization of the creditor's rights.

1.3.4 Harm to Senior Managers of the Company

The shareholder's defective capital contribution indirectly influences the interest of the senior managers. While the company's interest is harmed, it is inevitable to

bring about the negative influence on the performance of senior managers and their reputations.

2. ANALYSIS ON CHINESE SHAREHOLDER'S DEFECTIVE CAPITAL CONTRIBUTION SYSTEM AND PERFECT APPROACH

2.1 Analysis on Chinese Shareholder's Defective Capital Contribution System

Although the shareholder's defective capital contribution has its own defect, the deepest cause lies in lots of defects in the current system and legal regulations. It can be seen in several aspects below.

A. Incomplete obligation system of defective capital contribution. The main manifestations are introduced. a) In terms of the responsibility of shareholders of the defective capital contribution to the company, there is no express provision for the situation that the contribution in cash is not in place and the physical contribution is not implemented, though shareholders should undertake the duty of differential supplementary while the investment in kind is false. b) With regard of responsibility of shareholders of defective capital contribution to other shareholders, it only regulates that shareholders of defective capital contribution should undertake duties to other shareholders under a kind of breach form that they never perform the obligation of capital contribution. In fact, they should also take responsibility to other shareholders while their behaviors breach the obligation of capital contribution such as false investment and withdrawal of capital. c) The Chinese Corporation Law never clearly stipulates the responsibility of shareholders of defective capital contribution to the company creditors. d) For the "substantial responsibility of capital" of sponsor, it is only applicable for the case of the false physical contribution. It has no regulations for other cases of defective capital contribution. Therefore, the comprehensive obligation system of shareholder's defective capital contribution should be established. It should change the situation that current Corporation Law doesn't clearly determine the body of exertion of pressing for the contribution right. It should point out that the body of exertion of pressing for the contribution right should be the company under the situation of existence of company. In the case that the company fails to carry out, shareholders enjoy the right of action as the representative of shareholders.

B. In the field of liability structure, the administrative and criminal liabilities overweight the civil liability. It never really realizes the principle of the civil liability for compensation first. For example, for the behaviors seriously breaching the obligation of capital contribution such as withdrawal of capital and false contribution, Corporation Law only regulates the charging correction and penalty. If it constitutes the crime, it should investigate for criminal responsibility. However, these responsibilities are only ones that contributors should undertake to the nation rather than ones to the company, the company creditors and other shareholders. The losses that the company, company creditors and other honest shareholders suffer are not atoned due to the assumption of these obligations. Thus, the author agrees with the suggestion of some scholars that the Corporation Law should stipulate that, in the case of the serious defect existing in the shareholder's contribution, shareholders should be required to firstly undertake the civil responsibility to the

company, the company creditors and other shareholders while they are investigated for administrative and criminal responsibilities.

C. The civil liability of sponsor of incorporated company is less serious than that of shareholders of the limited liability company, which is obviously unreasonable. The setting procedure of the incorporated company is more complicated than that of the limited liability company. Also, its influence is larger than that of the limited liability company. Therefore, the sponsor of the incorporated company, particularly one established through the raising, should undertake more duties than shareholders of the limited liability company. However, in Chinese Corporation Law, the stipulation relevant to the shareholder's capital contribution liability arranged in the foundation of the limited liability company is not applicable for the sponsor of the incorporated company. The result is that the contribution responsibility of the sponsor of the incorporated company who should have undertook quite heavy duty yet is much lighter than that of the sponsor of the limited liability company.

2.2 Effective Approaches to Perfect the Shareholder's Defective Capital Contribution System

According to the practice of Chinese judiciary and the situation of China, to perfect Chinese shareholder's defective capital contribution system, we must implement the following points.

A. It should make the clear stipulation on the transfer of shares during the period of contribution. For instance, the death and bankruptcy of shareholders during the period of contribution will have the influence on the transfer of shares. Under such situation, it is allowed that other shareholders have the priority to purchase shares and the obligation to give the sufficient contribution.

B. The definition on the responsibility of the delay in contribution. Delay in contribution refers that shareholders perform their duties within the grace period after the date of contribution under the situation that they have the capital contribution ability. In the responsibility requirement, firstly, it should indicate that the delay interest should be calculated according to the bank rate of the corresponding period. Secondly, it should regulate the compensation for damage on breach. To remove the difficulties of the definition for damages, it should require the shareholders to make the compensation for damage of the company generated due to the delay in payment of contribution.

C. Punishment about the expulsion. The limit and proper application of the punishment measures, on one hand, are good for strengthening the force of constraint for the contribution obligation of shareholders. On the other hand, in the case that the inheritor gives up the right of inheritance and the shareholders go broke after the death and combination of shareholders, the limit and proper application are beneficial to protect the interest of the bankruptcy creditors, the nation and the successor of group.

3. CIVIL LIABILITY UNDERTAKEN BY SHAREHOLDERS OF DEFECTIVE CAPITAL CONTRIBUTION

Besides the administrative and criminal liabilities, the shareholders of defective capital contribution should also take the proper civil liability. Yet, Chinese Corporation Law doesn't conduct the comprehensive and specific stipulation in the civil liability of the shareholder's defective capital contribution. It is suggested that the civil liability should be continuously enhance from aspects below.

3.1 Liability of Shareholders of Defective Capital Contribution to Other Shareholders

According to Article 28 in Chinese Corporation Law, shareholders of the limited liability company should pay their assessment in full as regulated in the articles of the company. If shareholders don't or improperly pay their assessment as regulated in the company's provisions of the preceding paragraph, they should undertake the liability for breach to other shareholders who have paid their assessment in full such as keeping fulfilling, applying the remedial measures and compensation for loss.

3.2 Liability of Shareholders of Defective Capital Contribution to the Company

According to Article 28 in Corporation Law of China, it can be seen that, while the physical contribution is taken and the evaluation is false, shareholders of the defective capital contribution should undertake the "balance payment liability" and "defective joint liability" to the company. The shareholders who have paid their assessment in full take the "substantial responsibility of capital" to the company (Chen, 2002). Among them, the subject of the "balance payment liability" is the specific defective contributor discovered after the foundation of the company. Even though the contributor transfers his shares, he should also undertake the joint responsibility with the new shareholder for the amount of contribution never paid. The balance payment is the balance between the registered capital made up and the paid-in capital rather than the balance between the paid-in capital and the lowest registered capital. Therefore, if the subject matter used by the contributor as the contribution is not fit for the quality standard regulated by the nation or promised, it will lose the value or utility it has. As long as the company proposed the request about the defect of the subject matter within the specified period, the contributor should undertake the responsibilities according to the situation including reducing the price, replacement, repair, sales return, payment of penalty and compensation for loss.

3.3 Liability of Shareholders of Defective Capital Contribution to the Company Creditors

Generally, when the company has the viability and liquidity, shareholders of the defective capital contribution has no direct relationship with the company creditors who only have the debtor-creditor relationship with the company. The shareholders of the defective capital contribution needn't take the civil liability to the company creditors. However, while the creditors ask to pay off debts but the company has no ability to pay off, to protect the interest of creditors, the law should stipulate that the creditors have the right to ask shareholders to bear the liability under the situation

of the false investment. It should build the direct legal relationship between the shareholders of defective capital contribution and the creditors. When the corporate personality is denied due to the shareholder's defective capital contribution, the creditors can directly require the company shareholders to bear the unlimited liability.

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